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Aid, Growth and Jobs

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Abstract

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Comments

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Abstract

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1. Introduction

> *How* aid is spent may become more important than *how much* of it is spent. (Collier, 2012)

Collier was writing about how to make aid more effective for development, and he suggested several institutional innovations for making sure that whatever aid money is available is spent well. This study too is about how aid money can be spent well; but rather than addressing the limitations of *institutional mechanisms* for delivering aid, I examine the *objectives* of aid and making decisions about how to *allocate* scarce aid resources among alternative uses.

Various development objectives are worthy. The literature on aid to international development often reads like a wish list: do A, do B, do C ... and do Z. The problem is that A, B, C, and everything else add up to too much, both in terms of dollars and in terms of administrative capability. Priorities must be set.

Nowadays, development banks and aid agencies have remarkably similar objectives: 'A World Free of Poverty' (the World Bank), 'Fighting Poverty in Asia and the Pacific' (Asian Development Bank), 'Reducing Poverty and Social Inequalities' (Inter American Development Bank), and so on. Thus, one objective dominates all others: reducing the scourge of absolute economic misery in the world.[1]

This study focuses on an important but relatively underemphasized approach to poverty reduction: helping the poor earn more in the labour market for the work they do.[2] With higher labor market earnings, the poor will be better able to buy the goods and services they need to move up out of poverty.

2. Defining the Development Challenge

2.1 An Update on Global Poverty

Nearly half of the world's people live on less than US$2.50 purchasing power parity dollars (PPP$) per day. (PPP$ convert local currencies to US dollars adjusted for what money will buy.) In 2008, of the world's 6.7 billion people, 1.3 billion lived on less than 1.25 PPP$ per person per day and another 1.7 billion lived on between 1.25 and 2.50 PPP$ per person per day.[3] Of the world's poor, half live in just two countries, India and China. Another quarter live in sub-Saharan Africa (SSA). The remaining quarter are widely dispersed: in the rest of South Asia excluding India, the rest of East Asia excluding China, Latin America and the Caribbean, Eastern Europe and Central Asia, and the Middle East and North Africa.

Another feature about world poverty is that 72 per cent live in middle-income countries; twenty years earlier, 93 per cent lived in low-income countries (Kanbur and Sumner, 2011). This massive change in the location of poverty is not because low-income countries were so successful in reducing poverty (although some were), while middle-income countries were not. Nor is it because the world's poor migrated from low-income countries to middle-income countries. Rather, it is because a number of low-income countries became middle-income including the two most populous ones, China and India.

Certain characteristics of the poor are well known: they are more likely to be rural, more likely to be poorly educated, etc. Less well known is how the poor work, to which we now turn.

2.2 Poverty and Labour Earnings

An oft-repeated truism is that the only asset of the poor is their labour. Lacking assets and income from other sources, what makes the poor poor is that they are compensated very little for the work they do or they are unemployed and therefore earn nothing. International Labour Organization (ILO) figures show that unemployment befalls about 200 million people in the world at the present time.[4] Two hundred million is a lot of people, but it is a much smaller number than the estimated 900 million people whom the ILO reckons are employed but earning so little that they and their families cannot achieve a standard of living of even US$2 per person per day (ILO, 2014). Perhaps surprisingly, the unemployed are found disproportionately in *high-income countries* (ILO, 2014) and in *non-poor households within those countries* (Sabia and Burkhauser, 2010). Fighting unemployment is a legitimate policy challenge. However, the greater policy challenge is to generate higher earnings for those who are already working.

The people in the developing world are working hard and they are working poor. (*Working Hard, Working Poor* is the title of my most recent book, from which the following points are drawn.) Here are some of the main features of how people in the developing world are now working; see Fields (2012, Part One) for supporting data and citations:

Low Rate of Unemployment

Using standard ILO definitions of employment and unemployment, unemployment rates are *low* in low- and middle-income countries—lower than in high-income countries. The reason usually given is:

The Need to Work

The generally accepted explanation for below-average unemployment rates in developing countries is the so-called luxury unemployment hypothesis: few people in developing countries can afford to be unemployed for very long, so in order to earn something, they take up whatever employment is available or, failing that, create their own.

Insufficient Good Jobs

Jobs that are secure, pay well, and offer social protections are few in number relative to the number of workers who want such jobs and able to perform them.

Low Earnings Despite Long Work Hours

Average work weeks are long—at least 48 hours in Peru, Korea, Thailand and Pakistan, among others. And yet weekly earnings are low, because hourly earnings are so low. An Indian woman with whom I lived hand-rolls cigarettes for a living. Each day, she rolls a thousand of them, working very fast for eleven hours. This earns her a piece-rate of fifty Indian rupees per thousand— about US$1.10.

Uncertain Incomes

While the great majority of the working poor have the problem of low daily earnings when they work, they also have the problem of uncertainty about whether they will have work. Casual employment is much more prevalent than continuous, ongoing employment. Seasonality is endemic.

Where and How They Work

Most commonly, developing country workers work on farms and in their own micro-enterprises, not in factories and offices. Self-employment is the norm, wage and salaried employment the exception. Those in low-income countries work predominantly in rural areas; middle-income countries tend to be more urbanized. The workers are overwhelmingly informal, which is often defined as meaning that the enterprise is not registered with the government, the workers and the firm do not pay taxes, and therefore the workers do not receive social protections mandated or provided by the government. Unemployment benefits exist only for the best-off workers in developing countries.

The Special Problem of Indecent Work

A 17-year-old sex worker in Kenya named Alice says, 'I try to use condoms every time, but sometimes they refuse or offer much more money if we don't. If I am offered 200 [shillings] for sex with a condom or 1,000 [shillings] without, then I don't use condoms. I have to feed my baby'. Despite efforts to eliminate them, jobs that are outright indecent—modern-day slavery, indentured servitude, child prostitution, and the like—are far too common.

The Particular Disadvantages Faced by Women

Women in developing countries face all the labour market problems that men do, and then some. Women are less likely to be working in the paid labour force, more likely to be in low-paying occupations, more likely to be in precarious work, more likely to be victims of labour market discrimination, more likely to be low earners in self-employment, less likely to own land, and less likely to have secure land tenure rights.

Developing Countries' Employment Problems

The preceding profile tells us that what most developing countries have is primarily a problem of working poverty, not a problem of unemployment. 'Absorbing the unemployed' is precisely the wrong way of looking at the problem. 'Creating higher-paying employment opportunities' in wage employment or self-employment is a much more appropriate characterization.

2.3 In Summary

Three billion people in the world are poor. For every worker in the world who is unemployed, four-and-a-half workers are working poor. This means that most of the poor are poor because, despite working, they do not earn enough to enable their households to escape from poverty; they are not poor primarily because of unemployment. Not enough 'good jobs ' are available for all who want and can do them. Labour market policies aimed just at lowering unemployment focus on a small part of developing countries' labour market problems and ignore the much larger problem of low earnings among the employed. Raising the earnings of employed workers, be they in wage employment or self-employment, deserves more policy attention and development resources than are often given to it.

Let us now look at the principal policy options which developing countries and those that aid them face.

3. Policy Options for Improving Employment Outcomes[5]

Given the preceding facts about world poverty and the importance of labour incomes for determining poor households ' standards of living, how can aid be focused on *helping the poorer half of the world's workers earn their way out of poverty?* Let us assume that development assistance organizations have decided to devote at least some of their policy efforts and budgets to raising poor people's labour market earnings. For some of the poor, this will mean creating new wage and salaried employment into which they can move. For others of the poor, it will mean raising their self-employment earnings in the activities in which they are now engaged. For others still it will mean education, training and skills development. And all the poor are likely to be affected, for better or for worse, by policies with respect to economic growth, international trade, and the private sector.

The balance of this section presents some of the main policy options in each of these areas, indicating where possible some of the lessons from international experience which may prove informative in helping aid agencies, consortia of aid agencies, development banks, and client countries design better policies. We start with policies that are outside the labour market but have an important bearing on labour market outcomes for the poor, then turn our attention to labour market policies *per se*.

3.1 Economic Growth

International evidence reveals two general patterns about the relationship between economic growth and poverty change in the developing world (Fields, 2001; Asian Development

Bank 2007; United Nations Economic Commission for Latin America and the Caribbean 2011). First, when economic growth has taken place, poverty has fallen in the great majority of cases, though not all. Second, when poverty has not fallen, typically it is because economic growth has not taken place.

Why has economic growth *not* been shown to bring about poverty reduction everywhere? The answer lies in two observations.

One observation is an empirical pattern found in the data: although theory may lead us to expect that the poorest countries would enjoy higher proportionate rates of poverty reduction, empirically this is *not* the case for two reasons (Ravallion, 2012). One is that high initial poverty slows down economic growth, holding mean income constant. Another is that high initial poverty dulls the impact of growth on poverty reduction.

Another observation is the possibility of measurement problems. On the one hand, although economic growth may have been reported, it may not indeed have taken place. On the other hand, poverty may not have been recorded as falling, even though it may have been. A research task for the future is to examine these 'anomalous' data points one by one to ascertain which are valid and which are not.

For those country observations that are valid and in which poverty did not fall despite economic growth having occurred, we may then ask, 'why'? Two cases are illustrative.

Long ago, research I conducted on the Philippines during the presidency of Ferdinand Marcos (Fields, 1980) revealed that despite substantial economic growth, the real incomes of the poorest had *fallen* considerably. When I reported these results to the United States Agency for International Development, which had funded the research in the context of what they then called their 'New Directions in Development Assistance' program, they contacted the aid mission in the Philippines to inquire whether what the data showed was indeed true, and if it was, to redirect the United States' aid program accordingly so that the poor would be among the beneficiaries. Consequently, I met with officials from the Philippine national planning commission, who told me: 'What you reported is indeed true, but you left out one important thing: the increase in poverty took place under the previous planners, not us. ' What happened in the Philippines at that time was a blatant instance of 'crony capitalism': President Marcos and his cronies (including his infamous wife, Imelda) had stolen so much that the nation's poor had been rendered poorer.[6] This blatant corruption was a major factor in the overthrow of the Marcoses shortly thereafter.

A more recent example is the experience of my own country, the United States. In the 35 years preceding the Great Recession of 2007, real national income per capita grew by 113 per cent. Yet, using a constant real poverty line, the official poverty rate in the United States, which had fallen from 25 per cent when it was first calculated in 1962 to 12 percent by 1973, never fell lower. It exceeded 13 per cent in 2008 and is now above 15 per cent. Part of the reason for poverty not falling is that the labour market earnings of some important groups—for example, all men in the United States—are markedly lower than they were 40 years ago. Household incomes are down too: 7 per cent lower now in real terms than they were in 1999 (US Census Bureau 2014).

In current US political discourse, one side keeps repeating, 'If you tax the job creators, they won't create as many jobs'. This is a half-truth. It is probably true that private businesses will create fewer jobs the more they are taxed. But it is also true that the tax proceeds can and would be used by government specifically to create more jobs by hiring additional teachers for the schools, additional construction workers to rebuild roads and bridges, and additional police and firefighters. Who said that the goal of public policy is to maximize *private sector* employment? Important voices are being raised urging the United States to focus on raising *total* employment.[7]

Economic growth *in general* can be stimulated. So too can *pro-poor* economic growth, especially if aid agencies were to insist on answers to the question, 'how will this help the poor?' The Commission on Growth and Development, headed by the Nobel Prize-winning economist Michael Spence, reported (2008, 2009) that the fastest growing developing economies in the world had a number of features in common:

- They made the most of opportunities in the world economy.
- They maintained macroeconomic stability.
- They achieved high rates of savings and investment.
- They relied on markets to allocate resources but also intervened to affect what people brought to markets.
- They had committed, credible, and capable governments.

The Commission also presented a long list of 'bad ideas'. Among the ones relevant to employment and the labour market are relying on the civil service as an employer of last resort (as opposed to rural employment schemes, which serve as a social safety net), providing open-ended protection to specific sectors or jobs, paying civil servants less than they could earn elsewhere in the labour market, and abandoning an outward-looking market-driven growth strategy because of financial failures in the advanced countries.

In short, for economic growth to benefit the poor, mechanisms must be in place whereby growth reaches the poor. The poor can be reached through such direct mechanisms as job creation programs, overcoming the barriers to self-employment earnings, economic security programs, and skills development. They are less likely to be reached by reductions in corporate tax rates or personal tax rates at the upper end of the income distribution. Governments and the donors that work with them can influence policy by credibly assessing whether such mechanisms—especially labour market mechanisms—are in fact in place and help strengthen them or put them in place if they are not. Absent such mechanisms, the result may be a United States-style growth pattern in which the poor, the typical household, and the median worker are all left out.

3.2 International Trade

It has long been known that export growth is positively associated with wage growth (World Bank, 1995 p. 55). China, South Korea, Thailand, Indonesia, and Malaysia come out most positively on both dimensions. On the other side, we find Jordan, Ghana and Nigeria doing badly on both accounts.

Openness to trade is often measured as the sum of exports and imports. Exporting is good for labour market outcomes. It is not clear, though, that importing is. Indeed, the case has been made that East Asian growth was brought about by *export* expansion, not *import* expansion (World Bank, 1993).

Free trade is not necessarily fair and often is not. As countries consider whether to further open their economies to international trade, it is useful for country governments and donor agencies to think in terms of the effects on the poor. It is for reasons such as these that India and other countries have not allowed major retailers such as Wal-Mart to operate within their borders—small merchants with no alternative source of livelihood would get wiped out.

The usual argument for freer trade is that it may result in overall gains. However, these overall gains are not for everyone, and there are likely to be labour market losses for some, perhaps many. This is because labour markets are segmented, and therefore those workers who lose relatively good jobs may never recover their current earnings levels. Not surprisingly, they will resist freer trade unless they are compensated. Analysts across the political spectrum concur that, for practical if not always ethical reasons, those affected adversely by international trade need to receive some form of compensation. Martin Wolf of *The Financial Times* put it well: 'It would be immoral for rich countries to deprive the poor of the world of so large an opportunity for betterment merely because they are unable to handle sensibly and justly the distribution of the internal costs of a change certain to be highly beneficial overall. '

Expanded trade adjustment assistance, extended unemployment insurance benefits, and wage insurance are among the policies that have been proposed in the rich countries. So too are the elimination of farm subsidies, which have an important bearing on poor countries. Alas, in the current political climate, none of this is likely to happen any time soon.

3.3 Private Sector

Aid may be considered for improving the investment climate and in other ways stimulating private sector development. In formulating policies with respect to the private sector, it is important to bear in mind what is motivating companies. I believe the message of introductory microeconomics is right: that private companies are motivated by the drive for ever-higher profits. In the labour market, private companies will hire workers or not, pay them well or not, train them or not, or employ ‘high road human resource practices’ or not, depending on what is in their profit-maximizing interests to do. As former US Secretary of Labour Robert Reich (2007) has said, ‘Don’t believe for an instant that a company is going to sacrifice profits for the sake of social goals ...It’s not business’ business.’

Some analysts think that what is good for businesses is bad for workers and vice versa. Others disagree, seeing ample win-win opportunities. Many aspects of private sector development may not only enable companies to earn higher profits but also enable workers to benefit from increased employment and/or higher wages. But mutual gains are no more automatic than zero sum actions are.

Take the example of Intel, which decided to build a US$300 million semiconductor assembly and test plant in Costa Rica rather than in Brazil, Chile, Indonesia, Mexico, the Philippines or Thailand; 2,800 workers are now employed there. They also decided to build a number of major facilities in China rather than the United States. What questions does Intel ask when it makes locational decisions like these? Says its chairman, Craig Barrett, ‘What inherent strength does the country bring to the table?’ Explaining why Intel did *not* build a plant in the United States, the company’s CEO, Paul Otellini, explains:

> The things that are not conducive to investments [in the United States] are [corporate] taxes and capital equipment credits... If I build that factory in almost any other country in the world, where they have significant incentive programs, I could save US$1 billion... The cost of operating when you look at it after tax was substantially lower [in China] and you have local market access.

And why does Intel *not* build a plant in India? Says Barrett, ‘You don’t have infrastructure. Your electricity goes off four times a day’ (Fields, 2012 p. 127).

Intel does not need the workers of Costa Rica or China. On the other hand, the poor workers of Costa Rica and China desperately need the good jobs that Intel creates.

Private companies play an essential role in economic development as employers and taxpayers. Those governments, development institutions and aid agencies, non-governmental organizations, and ordinary citizens who are interested in helping the poor should explore ways of harnessing the energies of private companies toward mutually advantageous ends.

3.4 Generating More Paid Employment

If policy-makers in a country and the aid organizations that assist them decide to give priority to expanding the number of jobs for the poor in paid employment, what types of action within the labour market should they consider undertaking? International experience suggests lessons regarding a number of possible policy measures. (Note: Some of the policies for generating more paid employment may run directly counter to policies for increasing the earnings of those who are employed.)

First, *avoid prematurely high labour costs*. By ‘prematurely high labour costs’, I mean labour costs that are higher than they would have been if they had been set by supply and demand in the labour market. The great preponderance of evidence from all over the world shows a non-zero wage elasticity of demand for labour (Hamermesh 1993; Neumark *et al*., 2013).[8] Therefore, higher wages and other benefits—whether brought about by minimum wages, trade unions, public sector pay policies, multinational corporations, or labour codes—are likely to reduce employment below what it otherwise would have been. On the other hand, the bulk of the evidence also shows that the wage elasticity of demand for labour is less than one (in absolute value), and therefore higher wages would result in higher total wages being paid to workers (Freeman, 2010). There certainly are many development reasons that higher wages, more generous benefits, and greater labour market protections should be sought—and those who gain from these actions have very personal reasons to push for their continuation—but achieving increased wage and salaried employment is not one of them.

Second, *remove undue barriers to employment*. In many developing countries, employment protection laws are in place restricting dismissals of workers. While the workers covered by the legislation are in fact likely to enjoy more secure employment, there is also an unintended side effect: employers may be reluctant to hire workers in the first place, knowing that they cannot be dismissed in the event of a business downturn or unsatisfactory job performance. In India, where this phenomenon has been studied most carefully, stricter employment protection laws have been found to have resulted in lower employment and higher poverty (e.g., Besley and Burgess, 2004). India's Prime Minister Manmohan Singh, himself a distinguished economist, has asked: 'Is it possible that our best intentions for labour are not actually met by laws that sound progressive on paper but end up hurting the very workers they are meant to protect?' (Srivastava, 2011).

Third, *increase employees' skills and productive abilities to the extent that skill deficiencies are causing job vacancies to go unfilled*. Note the qualifier: to the extent that skill deficiencies are causing job vacancies to go unfilled. Employers do not hire the unemployed and underemployed for many reasons. If education and skills are expanded and additional skilled people join others in holding out for 'suitable' jobs, additional education and training may make labour market conditions worse, as has happened in a number of African economies (Bennell, 1996; Pritchett, 2001).

But in other circumstances, where employers are posting vacancies which they cannot fill because suitably qualified workers cannot be found, a different question arises: what is the best way to increase productive skills and abilities? The World Bank (2007) has classified educational policies according to those judged successful, those judged promising but unproven, and those judged unlikely to be successful.

As for post-schooling training, a good example for other countries to learn from is Mexico's vocational training system, known by its Spanish acronyms BECATE (Scholarships for Worker Training) and SICAT (System of Training Workers). The in-service training component of SICAT provides for employers to offer training in skills they need such as air-conditioner repairing and lathe operating; these are not necessarily the skills that would have been chosen by ministry officials in Mexico City. SICAT graduates have been found to have done better in the labour market than comparable individuals who did not undergo such training (Calderon-Madrid and Trejo, 2001).

Fourth, *create jobs for the poor*. Examples of such so-called 'workfare' programs are Argentina's Program for Heads of Households, Bangladesh's Food for Work Program, and India's National Rural Employment Guarantee Act (NREGA). General lessons have been drawn on how to design workfare schemes effectively (Ravallion, 2009).

NREGA is the most ambitious workfare program in the world for several reasons: because India is the world's second most populous country, because it is an employment *guarantee* scheme, and because the program has now been expanded to serve the poor in *each* of India's 600 districts. NREGA has been reported to have had some noteworthy positive effects (including reduction in distress out-migration, improved food security, employment with dignity, greater economic empowerment of women workers, and sustainable asset creation) but also some major problems (fewer than 100 days of work, non-payment of wages to persons who have performed work, and other ‘ operational deficiencies’). The government of India is well aware of these problems and is working actively to overcome them. The debate about NREGA continues to be a heated one (Abreu *et al*, 2014; Bhagwati and Panagariya, 2014).

Fifth, one potential policy intervention which it appears should *not* be done in general is to use scarce resources to improve labour market information systems such as online information centers, public employment services, job banks, and the like. Such services are well suited for situations in which employers want workers, workers want jobs, but the employers and workers cannot find one another—what labour economists call ‘frictional unemployment’. But it does not appear that unemployment and underemployment in developing countries are frictional in nature. What developing countries have is deficient demand in the wage and salaried labour market. Labour market information systems do not address this problem and so are not deserving of scarce development resources.

3.5 Increasing Self-employment Earnings

Finally, suppose that priority is given to increasing the self-employment earnings of the poor. What types of action might prove effective? International evidence indicates a number of interventions that have had positive effects in raising self-employment earnings.

First, *design products to help raise the productivity of the self-employed*. Organizations including International Development Enterprises, KickStart, Fuel from the Fields, One Laptop per Child, and D-Rev: Design for the Other 90 per cent have done this. A wide variety of highly affordable products have been developed. Among them: a WorldBike designed especially for transporting cargo; a mobile water purification tool called LifeStraws that enables people to suck water directly through a filter, thereby preventing water-borne diseases; a rolling water system called Q Drum that enables large quantities of water to be rolled from place to place rather than carried on one ’ s head or back; and a pot-in-pot cooling system with wet sand inserted between the two layers, enabling tomatoes to last for 21 days rather than two or three (Cooper-Hewitt, 2007; Polak, 2008).

Second, *adopt a positive policy stance toward the self-employed and avoiding hassling them*. In the cities of most developing countries, street traders and vendors are ubiquitous, selling lottery tickets, chewing gum, individual cigarettes, and whatever else those with money in their pockets may want to buy. But this general pattern is not found in South Africa. In the major cities there, one sees very few such workers. The reason is that the city councils have budgeted substantial sums for employing and equipping metro police officers to stop ‘illegal, unlicensed street trading’. What makes the street trading ‘illegal’ is that very few permits are issued, and therefore the vast majority of traders have to operate without them. This kind of official hostility is worse than needless; it is anti-development. If the city councils were to regard poverty reduction as a top priority, recognize that most of the poor people living in their jurisdictions have no choice but to earn their livelihoods from self-employment, and adopt a more positive or at least a less negative policy stance toward the self-employed, the urban poor would have a better chance of earning their way out of poverty. The informal economy should be nurtured, not repressed.

Third, *provide the poor in agriculture with more to work with*. Developing country farmers face many constraints including lack of land, water, other inputs, knowledge of best practice, access to product markets, protection against risk, and access to financial services. Land reform is, of course, one possible policy response. Others include: a system of rice intensification which enables more rice to be grown with fewer inputs; investment in irrigation; agricultural extension; crop insurance; and credit to farmers (on which more below). Aid agencies can help a lot. But where should they intervene?

Particularly promising is the work of the Bill and Melinda Gates Foundation, which has highlighted agricultural development as one of its priority areas for development assistance. When the Gates Foundation prioritizes something, not only does it make massive resources available but it also requires evidence on what works and what doesn't. With funding from the Gates Foundation, the International Food Policy Research Institute examined more than 250 possible interventions and concluded that 20 were 'proven successes'. They include the Green Revolution in Asia, improved maize in sub-Saharan Africa, pearl millet and sorghum in arid lands, connecting the milk grid in India, and land tenure reform in Vietnam (Spielman and Pandya-Lorch, 2009).

Fourth, *facilitate supplemental off-farm wage-employment and self-employment*. Even among farm households, it is the norm to have more than one activity (Banerjee and Duflo, 2007). Off-farm rural activities can be stimulated by a variety of means, as the experience of Taiwan showed, in contrast to that of South Korea. Both economies grew rapidly, but Taiwan's path was much more egalitarian than that of South Korea.

Fifth, *make capital available to the poor at affordable rates*. The poor lack six kinds of capital: human capital, business capital, infrastructure, natural capital, public institutional capital, and knowledge capital (Sachs, 2005). Consequently, the poor have only limited opportunities to raise the capital they need to be able to make profitable investments that might help lift them out of poverty. And indeed there are profitable investments to be undertaken: studies have calculated *monthly* rates of return of 15 per cent in Mexico and 5 per cent in Sri Lanka (McKenzie and Woodruff, 2006; de Mel et al, 2008).

On the matter of affordability of capital, the interest rates charged to the poor are often exorbitant: 4.69 per cent *per day* in Chennai, India; 40 per cent *per month* in the Philippines; and 10 per cent *per month* in much of the rest of the developing world. But such high interest rates can be avoided. The Grameen Bank in Bangladesh charges its borrowers 12-17 per cent interest *per year* and enjoys a nearly 100 per cent repayment rate. In the Indian state of Andhra Pradesh, banks make loans to groups of women at 12 per cent *per year*, and if the group repays on time, the state pays 9 per cent, leaving the borrowers to pay just 3 per cent annually. Andhra Pradesh enjoys a repayment rate of almost 100 per cent as well. Microcredit programs along such lines merit serious consideration in other places. Development banks and aid organizations could play an active role in funding them.

Sixth, *build skills and business know-how*. Among the many organizations involved in developing business know-how are: the ILO's Workers Activities Program (ACTRAV); Coca-Cola Sabco; Goldman Sachs' '10,000 Women' initiative; India's Self-Employed Women's Association (SEWA); a government-operated training scheme for the self-employed in Côte d'Ivoire (PAFPA); and the Foundation for International Community Assistance in Peru.

And seventh, *stimulate microfranchising* (Fairbourne *et al*., 2007). Microfranchising brings together microfranchisors (entrepreneurs who wish to expand their businesses) and microfranchisees (people who seek to operate their own self-employment activities but may not have the business know-how). Examples of successful microfranchising are: the Grameen Bank's Village Phone program and similar programs operated by the Grameen Foundation in Rwanda and elsewhere; VisionSpring, which makes available low-cost eye exams and affordable reading glasses; and Honey Care Africa, which sets up beekeepers with hives, loans, training, extension services, and a guaranteed market for their honey at fair trade prices.

3.6 In Conclusion

Many different possibilities for policy action have been raised in this section. How should policy-makers and aid donors choose from among them? Section 4 addresses this question.

4. Choosing the Most Promising Interventions

4.1 What to Emphasize?

We have considered in this study broad groups of policies to raise the labour market earnings of the poor: policies which take place primarily outside the labour market but have an important bearing on the labour market, including growth, trade, and private sector policies; policies within the labour market to increase paid employment; and policies within the labour market to increase the returns to self-employment.

Assuming that *a* priority for economic development, though not necessarily *the* priority for economic development, is to improve labour market outcomes for the poor, how should country governments and aid organizations choose among policies aimed at this objective? Policy-makers face two broad policy decisions: choosing *among* broad policy areas and choosing *within* a broad policy area.

Choosing *among* broad policy areas means deciding whether to allocate more development resources to one area (stimulating economic growth, for example) or to another (such as increasing paid employment). Similarly, choosing *within* a policy area means, for example, deciding to try to raise the returns to self-employment by increasing the availability of affordable microcredit or by investing in education and training. The do's and don'ts presented in the remainder of this section are equally applicable to both.

4.2 A Five-part Policy Evaluation Framework

Elsewhere, I have detailed a framework for policy evaluation. Here is the essence of it:

POLICY INSTRUMENTS → MODEL → OUTCOMES →

POLICY EVALUATION CRITERIA → POLICY EVALUATION JUDGMENT

The first step in the framework is to specify the action or alternative actions under consideration. These could be a law that might be passed, a regulation that might be imposed or removed, a tax, or a public expenditure.

The second step is to specify an analytical model. The best ones involve both theory and empirics, capturing the essential aspects of reality while leaving aside the less essential ones.

The third step is to use the model to predict the likely outcomes if the policy instrument were to be put into effect. In a labour market model, these outcomes might be changes in the number of workers in each type of job and the amounts they get paid.

The fourth step is to specify the policy evaluation criterion or criteria to be used. An example of a single policy evaluation criterion would be to analyze a proposed policy solely in terms of its effect on reducing poverty. Alternatively, an evaluation might be conducted in terms of multiple policy evaluation criteria such as increasing both employment and earnings. Some evaluators are comfortable using the traditional criteria of efficiency and equity.

The fifth and final step is to evaluate the outcomes in terms of the policy evaluation criterion or criteria and reach a judgment about whether the proposed policy would have positive, negative or ambiguous consequences.

Space does not permit a more detailed presentation of this framework. The interested reader is invited to consult Fields (2012, 2014a) for details.

4.3 Practical Questions to Be Asked

As we make policy proposals or evaluate the proposals of others, it would be good to seek the best possible answers to the following three questions:

- What specific labour market objective or objectives are you trying to achieve and by what welfare economic criterion or criteria will you decide if your objective(s) is/are being achieved?
- What theoretical labour market model are you using to analyze the effects of the proposed policy?
- What is the empirical evidence favouring one view of labour market functioning over another?

These three questions are the ideal. They define what we want to strive for, even if the ideal is seldom attained or even approximated. But let us not allow the best to be the enemy of the good. Professional economists and other social scientists can and should speak out even when we are not 95 per cent confident of our conclusions, because others are speaking out based on hunches, and our hunches should be heard too.

5. Concluding Thoughts

The three preceding sections defined the global poverty challenge and the world's employment problem, presented policy options for improving employment outcomes, and suggested ways of choosing the most promising interventions. Let us conclude with a few final observations.

The first is to try to specify what constitutes a minimally acceptable foundation for a policy recommendation. To the extent that developing country governments and the donors that aid them are concerned about the economic well-being of the poor and in particular with their labour market earnings, three questions should be asked about proposed policies. First, is the contemplated action good for workers in general and for poor workers in particular? It is not enough just to ask whether the action in question would be good for the private sector. Second, how cost-effective is the proposed action? How do the direct benefits compare with the direct costs? And third, what about opportunity costs? Is the proposed policy not only *good* but is it *better* than some other policy? Time and resources may not permit these questions to be answered fully, but that is no excuse for ignoring them entirely.

The second is a question about how to think about targeting aid aimed at reducing poverty. The usual starting point is to think about aid to *poor countries*. However, given that more than 70 per cent of the absolutely poor people in the world live in *middle- income* countries, not *low-income* ones, if the majority of the world's poor are not to be excluded from aid efforts, aid must be made available to the countries where the poor are and targeted on *poor people* in those countries. Lessons from the economics of targeting—fine targeting, categorical targeting, indicator targeting, and self-targeting—can help aid be more focused on helping the poor.

The third is where to seek applicable lessons. Most aid organizations are structured geographically: sub-Saharan Africa, Latin America and the Caribbean, and so on. But many of the good ideas from international evidence come from countries that may not be nearby geographically but are near in terms of level of economic development. Nigeria may be able to draw relevant lessons from India's experience with its National Rural Employment Guarantee Act (both are lower-middle-income economies), and likewise Malaysia from Mexico's System of Training Workers (both are upper-middle-income countries).

Fourth, one particularly important gap in knowledge is how labour market conditions change within countries in the course of economic growth and non-growth. Are the optimists right that workers typically experience more and better job opportunities as economic growth takes place? Or are the pessimists right that most often those who enjoy economic and political power are able to work the system to their own advantage, thus causing poor workers to be left out or even immiserized? An ongoing WIDER study of 16 Latin American countries will soon shed light on this vitally important question.

And finally, research is desperately needed on the question of how developing country labour markets actually work. As stressed above, sound labour market policies require sound labour market models. To be able to better design policy interventions, it is vital for policy-makers and development organizations to be able to work with such models. It remains for more of them to be developed.

Notes

1. When poverty is thought of in absolute terms, a poverty line is fixed in real dollars (or rupees or pesos) and is adjusted over time for inflation and only for inflation. The amount of poverty is then gauged by looking at those whose incomes or consumption are below the line and seeing how many of them there are, how far below the poverty line they are, and/or how unequal is the distribution of income among them. Absolute poverty is the focus of discourse in the United States and India, among others. Poverty conceived of in such absolute terms differs from the European notion of relative poverty, in which people are classified as poor by Eurostat if they live in households where the equivalized income is less than 60 per cent of the national equivalized median.
2. The 'labour market' is defined here as the place where labour services are bought and sold. In the case of an employer- employee relationship, the employer buys the labour services of the employee. In the case of self-employment, an individual buys labour services from oneself. The poorer the country, the more important is self-employment vis-à-vis wage and salaried employment. For more on self-employment in developing economies, see Fields (2014b).
3. The number living on less than US$1.25 PPP per day is reported in Chen and Ravallion (2013). I thank Shaohua Chen for providing me with a specialized POVCAL run estimating the number in the US$1.25-2.50 range.
4. The ILO defines a person as 'employed' if he or she worked one hour or more for pay or 15 hours or more not for pay in the preceding week. A person who was not employed but who actively looked for work is counted as 'unemployed'. A third group is those who were not employed but who were not actively looking for work—say, because they were

too old, too young, or too sick; these people are counted as ‘not in the labour force’ or, synonymously, ‘economically inactive’.

5. This section is based on Fields (2012, Part Two), to which interested readers are referred for additional details.
6. *The New York Times* (26 March 2004, p. A6) published a list of ‘embezzling leaders’ compiled by Transparency International. Ferdinand Marcos was number two on the list, after Indonesia’s Suharto. Marcos is estimated to have stolen US $5 billion to US$10 billion during his 14-year presidency.
7. See, for example, Krueger (2012), Stiglitz (2012), and Yellen (2014).
8. One notable exception is the study by Card and Krueger (1995) of fast-food workers in the United States.

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